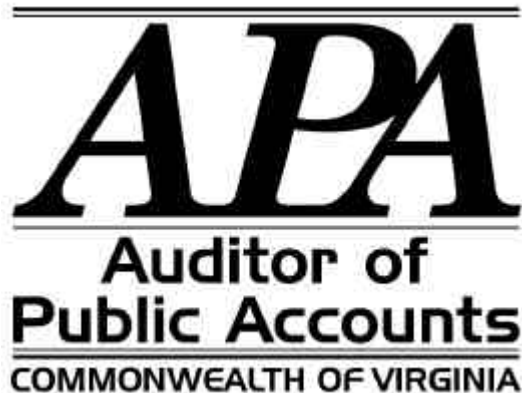


**DEPARTMENT OF ENVIRONMENTAL QUALITY
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2001**



AUDIT SUMMARY

Our audit of the Department of Environmental Quality for the year ended June 30, 2001, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in internal control; and
- no instances of noncompliance with applicable laws and regulations tested that are required to be reported.

- TABLE OF CONTENTS -

AUDIT SUMMARY

SELECTED AGENCY INFORMATION:

General Overview

Virginia Water Quality Improvement Fund

Title V Air Permitting Program

The Virginia Petroleum Storage Tank Fund

Status of Systems Development Projects

INDEPENDENT AUDITOR'S REPORT

AGENCY OFFICIALS

SELECTED AGENCY INFORMATION

General Overview

The Department of Environmental Quality (the Department) protects the Commonwealth's natural resources by administering state and federal environmental programs, issuing permits, monitoring water and air quality, and inspecting waste facilities. The Department conducts extensive monitoring to ensure compliance with state and federal standards for water quality, air quality, and waste management. The Department also enforces regulations promulgated by the State Water Control Board, the Board of Waste Management, and the Air Pollution Control Board.

The Department operates through its central office, seven regional offices, and four satellite and specialized offices. The following chart illustrates the Department's funding sources and spending levels for fiscal year 2001 compared with fiscal year 2000.

<u>Revenues:</u>	<u>2001</u>	<u>2000</u>
General Fund appropriations	\$ 48,799,371	\$ 55,122,256
Capitalization grants	50,012,670	23,048,994
Other federal grants	14,344,456	14,471,019
Taxes and fees	41,836,012	39,777,658
Permits fees	10,267,606	10,489,871
Other sources	<u>11,501,309</u>	<u>10,825,070</u>
 Total revenues	 <u>\$176,761,424</u>	 <u>\$153,734,868</u>
 <u>Expenses and loan disbursements:</u>		
Technical and financial assistance	\$101,845,733	\$ 62,271,728
Response and remediation	38,402,242	37,408,151
Resources management	29,541,046	27,227,737
Administration and support	19,011,508	20,173,000
Monitoring and evaluation	8,571,108	7,959,868
Other	<u>6,336,694</u>	<u>4,669,956</u>
 Total expenses	 <u>\$203,708,331</u>	 <u>\$159,710,440</u>

Tax revenues represent funds collected by other agencies and transferred to the Department for activities such as litter control, petroleum tax, vehicle emissions inspection, water quality permits, and waste tire disposal. Other sources of revenues include recovery of indirect costs, civil penalties and charges, interest, and miscellaneous revenue. Other program expenses include research and planning, policy and program development, and information and education assistance.

Funding and spending levels have been relatively stable over the past two years with the exception of Capitalization Grant revenues, and expenses incurred with technical and financial assistance. Increased activity in the Virginia Revolving Loan Fund is the major source of these exceptions. This fund provides federally-funded financial assistance in the form of low-interest loans to local governments for needed wastewater treatment improvements at publicly-owned wastewater collection and treatment facilities. The Department administers the policy aspects of the loans, determines loan recipients, establishes and disburses loan amounts, and sets repayments terms. The Virginia Resources Authority serves as the Fund's financial manager. During the fiscal year 2001, the Department facilitated the closing of 20 loans, including a loan in excess of \$40,000,000, of which \$26,000,000 was federal funds, to a single locality.

Virginia Water Quality Improvement Fund

The Water Quality Improvement Fund provides grants to local governments, soil and water conservation districts, and individuals for point and nonpoint source pollution prevention, reduction, and control projects. The Department administers the point source pollution control portion of the program. The program's primary funding source consists of ten percent of the annual General Fund revenue collections that are in excess of the official estimates in the General Appropriation Act and ten percent of any unreserved General Fund balance at the close of each fiscal year whose reappropriation is not required in the General Appropriation Act. As of January 4, 2002, the Department has awarded \$98.89 million in reimbursement-basis grants for water quality improvement projects in support of 25 grant agreements.

To date, reimbursements total approximately \$54 million (55 percent of grants awarded). The following chart shows Water Quality Improvement Fund financial activity.

Financial Activity - Fiscal Years 1998 through 2001

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Revenues:				
General Fund appropriations	\$10,000,000	\$37,100,000	\$25,244,294	\$10,284,034
Interest revenue	<u>434,358</u>	<u>2,463,445</u>	<u>3,280,393</u>	<u>3,497,848</u>
Total revenues	10,434,358	39,563,445	28,524,687	13,781,882
Expenditures	<u>(2,688,177)</u>	<u>(5,673,418)</u>	<u>(14,828,232)</u>	<u>(30,850,141)</u>
Net increase (decrease)	7,746,181	33,890,027	13,696,455	(25,068,259)
Beginning fund balance	<u>-</u>	<u>7,746,181</u>	<u>41,636,208</u>	<u>55,332,663</u>
Ending fund balance	<u>\$7,746,181</u>	<u>\$41,636,208</u>	<u>\$55,332,663</u>	<u>\$38,264,404</u>

As shown above, approximately \$38.3 million is available to support point source program objectives. The Fund's total obligation for work remaining under the original 25 grant agreements is \$45.9 million.

Title V Air Permitting Program

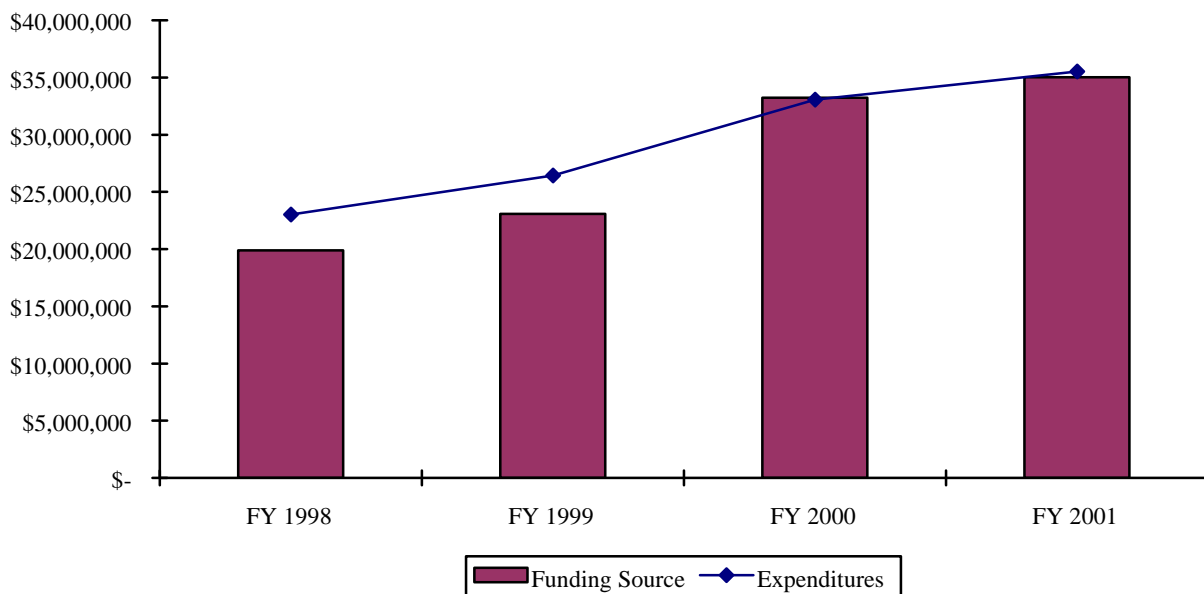
Title V of the Clean Air Act requires that each state develop a self-supporting operating permit program to apply state and federal requirements to stationary air pollution sources. The Department does this through their Air Permitting Program. The Department assesses fees based on the amount of pollutants released into the air and does the Title V annual permit program fee calculations annually using the Consumer Price Index. As of December 31, 2001, the Department has 303 Title V air facilities. In fiscal year 2001, Title V revenue and expenses totaled \$9,953,194 and \$10,638,441, respectively. The Program's accumulated fund balance absorbed the deficiency in revenues collected. The fund balance at June 30, 2001, was \$10,806,485.

The Virginia Petroleum Storage Tank Fund

The Virginia Petroleum Storage Tank Fund reimburses approved clean-up costs and some third-party damages resulting from petroleum releases from storage tanks. The primary revenue for the Fund comes from a \$.006 per gallon fee on regulated petroleum products sold in Virginia. Regulated products

include gasoline, aviation motor fuel, diesel fuel, kerosene, and heating oil. The following graph shows Petroleum Storage Tank Fund financial activity over the last four years.

Financial Activity - Fiscal Years 1998 through 2001



Because over the last several years, total expenses (\$118 million) have outpaced total revenues (\$111.2 million), the Department delays reimbursement payments for periods of eight months or more pending availability of funds. The Department attributes this situation to an increase in:

- The number of claims for residential releases
- Claims related to tank releases discovered near the December 1998 deadline for tank replacement
- Public awareness of the possibility of reimbursement from the state

For petroleum releases reported after March 31, 2001, the Department had announced its intention to defer payment on the first \$10,000 of approved costs indefinitely. This would allow a wider distribution of available money for approved claims. The Department is studying alternatives to address the current imbalance between demand and revenue.

Status of Systems Development Projects

The Department is continuing its effort to develop and implement new information systems. The following is a listing of the significant systems projects and their progress.

Oracle Financials - The Department acquired Oracle Financials to replace its legacy systems. The Department contracted with PricewaterhouseCoopers for implementation of support services for five modules: General Ledger, Accounts Payables, Purchasing, Fixed Assets, and Accounts Receivable. The Department has also installed two other Oracle modules: Oracle Projects, a time reporting module, and Oracle Human Resources Management System (HRMS). The Department has upgraded

to a browser-based system from the client/server-based system. This upgrade also included a web-enabled Oracle time sheet system, which replaced the current Personal Time and Expense module. The implementation of Oracle Financials is complete and is their primary financial reporting system, interfacing directly to the Commonwealth's financial system.

Comprehensive Environmental Data System (CEDS) - CEDS provides functions for database management, application and issuance tracking, and compliance for the Department's regulatory programs. Fully implemented, the system replaces approximately 77 systems that ran on various platforms. CEDS contains two versions: Version 1, completed in December 1999, included all components essential for Y2K compliance and Version 2, completed in December 2001, enables CEDS to interface with other systems. CEDS Version 2 includes implementation of electronic discharge monitoring report capability and improvements to the Air Permit Generation System. The Department plans to move a number of business processes to the Internet for public access.

As of January 1, 2002, the Department has spent approximately \$12.3 million on this project. Current budget costs are \$1,092,122 during the period of January 2002 to June 2002 for maintenance of the system.

May 21, 2002

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Environmental Quality** for the year ended June 30, 2001. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenues	Payroll
Expenditures	Fixed Assets
Contract Management	Information Systems
Leases	

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on May 7, 2002.

AUDITOR OF PUBLIC ACCOUNTS

NJG/kva
kva:37

DEPARTMENT OF ENVIRONMENTAL QUALITY
Richmond, Virginia

Robert G. Burnley, Director

STATE BOARD OF WASTE MANAGEMENT

Ralph B. Smith, Jr., Chairman

Gary H. Baise	Susan M. Eckerly
Ronald E. Bowman	Richard D. Pluta
Donald L. Carty	Sheila Woodard McAllister

STATE AIR POLLUTION CONTROL BOARD

Paul G. Anderson	Karlynn W. Bucher
Gary H. Baise	JoAnne Scott-Webb

Frederick O. Walker

STATE WATER CONTROL BOARD

Hunter E. Craig, Chairman

Gary H. Baise	Thomas V. Van Auken
H. Preston Futrell, Jr.	Karl F. Wenger